NetDragon Websoft Inc.
網龍網絡有限公司

(incorporated in the Cayman Islands with limited liability)

(Stock Code: 777)

SUPPLEMENTAL ANNOUNCEMENT IN RELATION TO THE ANNUAL REPORT OF THE COMPANY FOR THE YEAR ENDED 31 DECEMBER 2014

The board (the "**Board**") of directors (the "**Directors**") of NetDragon Websoft Inc. (the "**Company**") makes this announcement in relation to its annual report for the year ended 31 December 2014 published on 10 April 2015 (the "**Annual Report**"). Unless otherwise stated, capitalized terms used in this announcement shall have the same meanings as defined in the Annual Report.

The Company would like to provide the following additional information to the Annual Report relating to the ND Structure Contracts and the Best Assistant Control Documents (together, the "**Contractual Arrangements**") which are disclosed under the paragraphs headed "Connected Transactions" of the Annual Report.

Reasons for entering into the Contractual Arrangements

As NetDragon (BVI) and Best Assistant are companies incorporated in the British Virgin Islands and Cayman Islands respectively, their PRC subsidiaries, TQ Digital, TQ Online and Fujian Tianquan are considered as wholly foreign-invested enterprises. As stated below, the PRC government restricts foreign investment in value-added telecommunications businesses. The arrangements under the Contractual Arrangements are designed specifically to confer upon TQ Digital and TQ Online (in the case of the ND Structure Contracts) and Fujian Tianquan (in the case of the Best Assistant Control Documents) the right to enjoy all the economic benefit of NetDragon (Fujian) and Fujian Huayu respectively, and to prevent leakages of assets and values of NetDragon (Fujian) and Fujian Huayu to their ultimate shareholders.

Risk Relating to the Contractual Arrangements

There is no assurance that the Contractual Arrangements are in compliance with existing or future PRC laws and regulations.

According to the Administrative Rules for Foreign Investments in Telecommunications Enterprises (外商投資電信企業管理規定) issued by the State Council on 11 December 2001 and amended on 10 September 2008, foreign investors' ultimate equity ownership in an entity in the PRC providing value-added telecommunications services shall not exceed 50% and a foreign investor wishing to acquire any equity interest in a value-added telecommunications business in the PRC must demonstrate (i) a good track record and (ii) experience in providing value-added telecommunications services overseas ("**Qualification Requirement**").

NetDragon (Fujian) and Fujian Huayu are principally engaged in the online game business and online education business in the PRC respectively. Under the current PRC regulatory circumstances, TQ Digital, TQ Online and Fujian Tianquan, as wholly foreign owned enterprises, would not be able to obtain the relevant business license(s) of such business and thus is unable to provide the value-added telecommunications services in the PRC directly. In compliance with 外商投資電信企業管理規定 (Administration Rules for Foreign Investments in Telecommunication Enterprises) ("**FITE Regulations**") and other relevant laws, TQ Digital and TQ Online would not be able to hold more than 50% equity interests in NetDragon (Fujian), while Fujian Tianquan would not be able to hold more than 50% equity interests in Fujian Huayu, which would render TQ Digital, TQ Online and Fujian Tianquan ineligible to obtain the relevant business license(s).

The Ministry of Industry and Information Technology of the PRC (中華人民共和國工業和信息化部) ("**MIIT**"), MIIT has issued a guidance memorandum on the application requirement for establishing foreign-invested value-added telecommunications enterprises in the PRC. According to this guidance memorandum, an applicant is required to provide, among other things, the applicant's annual reports for past three years, proof of Qualification Requirement and business development plan. The guidance memorandum does not provide any further guidance on the proof, record or document required to satisfy the Qualification Requirement. Further, this guidance memorandum does not purport to provide an exhaustive list on the application requirement. Save for the aforesaid guidance memorandum, as at the date of this announcement, no applicable PRC laws, regulations or rules have provided clear guidance or interpretation on the Qualification Requirement.

The Group has a record of operating online games overseas, which is likely to be considered as operation of value-added telecommunications business overseas. However, due to lack of clear guidance or interpretation, it is uncertain whether such record would be deemed to satisfy the Qualification Requirement by the relevant government authorities.

On 13 July 2006, the MIIT issued the Circular on Strengthening the Administration of Foreign Investment in and Operation of Value-added Telecommunications Business (關於加強外商投資經營增值電信業務管理的通知) ("**MIIT Circular**"), which reiterated restrictions on foreign investment in telecommunications businesses. Under the MIIT Circular, a domestic company that holds an ICP License is prohibited from leasing, transferring or selling the license to foreign investors in any form, and from providing any assistance, including providing resources, sites or facilities, to foreign investors to provide ICP services illegally in the PRC. Due to a lack of interpretative materials from the authorities, it cannot be assured that the MIIT will not consider the Contractual Arrangements as a kind of foreign investment in telecommunications services, in which case the Group may be found in violation of the MIIT Circular.

Our PRC Legal Advisor is of the opinion that except for the dispute resolution clause as mentioned under the paragraph headed "Certain terms of the Best Assistant Control Documents may not be enforceable under PRC laws" below, (i) the Contractual Arrangements are legal, valid and binding on the parties to the agreements under the Contractual Arrangements, and (ii) each of the structure contracts under the Contractual Arrangements does not violate any mandatory provisions of current PRC laws promulgated by the National People's Congress of the PRC or its Standing Committee, or of any mandatory provisions of administrative regulations issued by the State Council of the PRC.

As of the date of this announcement, the Company has not encountered any interference from any governing bodies in operating its business through NetDragon (Fujian) and/or Fujian Huayu under the Contractual Arrangements.

However, it cannot be assured that the PRC government or judicial authorities would agree that the Contractual Arrangements comply with PRC licensing, registration, other regulatory requirements or policies that may be adopted in the future. If the PRC government or judicial authorities determines that the Contractual Arrangements does not comply with applicable laws and regulations, it could have broad discretion in dealing with such incompliance, including:

1. requiring the nullification of the Contractual Arrangements;

2. levying fines and/or confiscating the proceeds generated from the operations under the Contractual Arrangements;

3. revocation of the business licenses or operating licenses of NetDragon (Fujian), Fujian Huayu, TQ Digital, TQ Online and/or Fujian Tianquan;

4. discontinuing or placing restrictions or onerous conditions on the business operations of NetDragon (Fujian), Fujian Huayu, TQ Digital, TQ Online and/or Fujian Tianquan;

5. imposing conditions or requirements which the Group may not be able to comply with or satisfy;

6. requiring the Group to undergo a costly and disruptive restructuring; and

7. taking other regulatory or enforcement actions that could be harmful to or even shut down online game business and/or online education business of the Group.

The imposition of any of the above-mentioned consequences could result in a material and adverse effect on the Group's ability to conduct its business. In addition, if the imposition of any of these consequences causes TQ Digital, TQ Online and/or Fujian Tianquan to lose the rights to direct the activities of NetDragon (Fujian) and/or Fujian Huayu or their respective rights to receive their economic benefits, the Group would no longer be able to consolidate the financial results of NetDragon (Fujian) and/or Fujian Huayu and thus affect its financial results.

TQ Digital, TQ Online and Fujian Tianquan relies on the Contractual Arrangements to control and obtain the economic benefits from NetDragon (Fujian) and Fujian Huayu, the operating entities in the PRC, which may not be as effective in providing operational control as direct ownership.

The Contractual Arrangements may not be as effective in exercising control over NetDragon (Fujian) and Fujian Huayu when compared to equity ownership. NetDragon (Fujian), Fujian Huayu and their ultimate equity holders could breach or fail to perform their obligations under the Contractual Arrangements. If TQ Digital, TQ Online and/or Fujian Tianquan had direct ownership of NetDragon (Fujian) and/or Fujian Huayu, they would be able to exercise its rights as a shareholder to effect changes in its board of directors, which in turn could effect changes, subject to any applicable fiduciary obligations, at the management and operational level. Under the Contractual Arrangements, TQ Digital, TQ Online and/or Fujian Tianquan would need to rely on its rights under the Cooperation Framework Agreement, the Technical Support Services Agreement and the Proxy Agreement to effect such changes, or designate new equity holders for NetDragon (Fujian) and/or Fujian Huayu under the Exclusive Acquisition Rights Agreement.

If NetDragon (Fujian), Fujian Huayu and/or their ultimate shareholders breach their obligations under the Contractual Arrangements or if TQ Digital, TQ Online and/or Fujian Tianquan loses effective control over NetDragon (Fujian) and/or Fujian Huayu for any reason, TQ Digital, TQ Online and/or Fujian Tianquan would need to bring a claim against them under the terms of the Contractual Arrangements. The Contractual Arrangements are governed by the PRC law and provide that any dispute arising from these arrangements will be submitted to the Fuzhou International Economic and Trade Arbitration Commission ("FIETAC"), for arbitration, the ruling of which will be final and binding. Furthermore, personal liabilities of ultimate shareholders of NetDragon (Fujian) may also subject the equity interest they hold in NetDragon (Fujian) and Fujian Huayu to court preservation actions or enforcement. The legal framework and system in the PRC, particularly those relating to arbitration proceedings, is not as developed as other jurisdictions such as Hong Kong. As a result, significant uncertainties relating to the enforcement of legal rights through arbitration, litigation and other legal proceedings remain in the PRC, which could limit TQ Digital, TQ Online and/or Fujian Tianquan's ability to enforce the Contractual Arrangements and exert effective control over NetDragon (Fujian) and/or Fujian Huayu. If Fujian Huayu, NetDragon (Fujian) and/or their ultimate shareholders fail to perform their respective obligations under the Contractual Arrangements, and TQ Digital, TQ Online and/or Fujian Tianquan is unable to enforce the Contractual Arrangements, or suffer significant delay or other obstacles in the process of enforcing the Contractual Arrangements, the Group's business and operations could be severely disrupted, which could materially and adversely affect its results of operations.

Certain terms of the Best Assistant Control Documents may not be enforceable under PRC laws.

The Best Assistant Control Documents provide for dispute resolution by way of arbitration in accordance with the arbitration rules of the FIETAC in the PRC. The Best Assistant Control Documents contain provisions to the effect that the arbitral body may award remedies over the shares and/or assets of Fujian Huayu, injunctive relief and/or winding up of Fujian Huayu. In addition, the Best Assistant Control Documents contain provisions to the effect that courts in Hong Kong and the Cayman Islands are empowered to grant interim remedies in support of the arbitration pending the formation of an arbitral tribunal.

However, the PRC Legal Advisor has advised that the abovementioned provisions contained in the Best Assistant Control Documents may not be enforceable. Under PRC laws, an arbitral body granting any injunctive relief or provisional or final liquidation order to preserve the assets of or any equity interest in PRC legal entities in case of disputes shall submit the application to courts in the PRC. Therefore, such remedies may not be available to Fujian Tianquan, notwithstanding the relevant contractual provisions contained in the Best Assistant Control Documents. PRC laws allow an arbitral body to award the transfer of assets of or an equity interest in Fujian Huayu in favour of an aggrieved party. In the event of non-compliance with such award made by the arbitral body, enforcement measures may be sought from the court.

However, the court may or may not support the award of an arbitral body when deciding whether to take enforcement measures. Under PRC laws, courts of judicial authorities in the PRC generally would not grant injunctive relief or the winding-up order against Fujian Huayu as interim remedies to preserve the assets or shares in favour of any aggrieved party. Our PRC Legal Advisor is also of the view that, even though the Contractual Arrangements provide that courts in Hong Kong and the Cayman Islands may grant and/or enforce interim remedies or in support of arbitration, such interim remedies by overseas courts may not be recognized or enforced by PRC courts. As a result, in the event that Fujian Huayu, NetDragon (Fujian) and/or any of their ultimate shareholders breaches any of the Best Assistant Control Documents, Fujian Tianquan may not be able to obtain sufficient remedies in a timely manner, and its ability to exert effective control over Fujian Huayu and conduct its business could be materially and adversely affected and the financial performance of the Group could be materially and adversely affected.

The Contractual Arrangements may be subject to scrutiny by the PRC tax authorities and any finding that TQ Digital, TQ Online, Fujian Tianquan, Fujian Huayu and/or NetDragon (Fujian) owes additional taxes could substantially reduce the consolidated net income and the value of the Group.

Under the Contractual Arrangements, NetDragon (Fujian) will transfer all of its profits to TQ Digital and TQ Online, while Fujian Huayu will transfer all of its profits to Fujian Tianquan. Such profits will be net of any accumulated loss, working capital requirements, expenses and tax and therefore substantially reduce NetDragon (Fujian) and Fujian Huayu's taxable income. These arrangements and transactions are related party transactions which must be conducted on an arm's length basis under applicable PRC tax rules. In addition, under PRC laws and regulations, arrangements and transactions among related parties may generally be subject to audit or scrutiny by the PRC tax authorities within ten years after the taxable year when the arrangements or transactions are conducted. As a result, the determination of service fees and other payments to TQ Digital and TQ Online by NetDragon (Fujian) and to Fujian Tianquan by Fujian Huayu under the Contractual Arrangements may be challenged and deemed not in compliance with such tax rules. The Group could face material and adverse tax consequences if the PRC tax authorities determine that the

Contractual Arrangements were not entered into on an arm's length basis and therefore adjust the taxable income of NetDragon (Fujian) and/or Fujian Huayu in the form of a transfer pricing adjustment which refers to the prices that one member of a group of affiliated corporation's charges to another member of the group for goods, assets, services, financing or the use of intellectual property. A transfer pricing adjustment could, among other things, result in a reduction, for PRC tax purposes, of expense deductions recorded by NetDragon (Fujian) and/or Fujian Huayu, which could in turn increase NetDragon (Fujian) and/or Fujian Huayu's tax liabilities. Any such adjustment could result in a higher overall tax liability of the Group. In addition, the PRC tax authorities may impose late payment fees and other penalties on NetDragon (Fujian) and/or Fujian Huayu for any unpaid taxes. The consolidated net income of the Group may be materially and adversely affected if NetDragon (Fujian) and/or Fujian Huayu's tax liabilities increase or if it is subject to late payment fees or other penalties. As a result, the value of the Group may be materially and adversely affected.

Unwinding of the Contractual Arrangements

It is the intention of the Group to unwind the Contractual Arrangements when foreign investment in the development and operation of online game and online education business is no longer restricted in the PRC.

However, as at the date of this announcement, there is no unwinding of any of the Contractual Arrangements or failure to unwind when the restrictions that led to the adoption of the Contractual Arrangements are removed.

By order of the Board
NetDragon Websoft Inc.
Liu Dejian
Chairman

Hong Kong, 10 August 2015

As at the date of this announcement, the Board comprises four executive Directors, namely Mr. Liu Dejian, Mr. Liu Luyuan, Mr. Zheng Hui and Mr. Chen Hongzhan; one non-executive Director, namely Mr. Lin Dongliang; and three independent non-executive Directors, namely Mr. Chao Guowei, Charles, Mr. Lee Kwan Hung and Mr. Liu Sai Keung, Thomas.